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No. 87-306

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

WILLIAM CONDREN and INTERNATIONAL AIR LEASES, INC.,

Petitioners,

—against—

AIRCRAFT TRADING AND SERVICES, INC.,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Opinions Below

The opinion of the Second Circuit Court of Appeals dated May 22, 1987 is reported at 819 F.2d 1227 and appears at Appendix A of the Petition. The opinion of the United States District Court for the Southern District of New York dated October 3, 1986 has not been officially reported and appears at Appendix B of the Petition.

Jurisdiction

The jurisdictional requisites are adequately set forth in the Petition.

Questions Presented

Whether this case presents any question of Federal Law under Sections 503(c) and 506 of the Federal Aviation Act [49 U.S.C. §§1403(c) and 1406], as interpreted by *Philko Aviation, Inc.* v. *Shacket,* 462 U.S. 406 (1983) or, whether this case merely involves questions of state law under the Uniform Commercial Code.

Statutory Provisions Involved

The pertinent provisions of the Federal Aviation Act are set forth in the Petition at pages 2-3. The relevant and controlling provisions of the Uniform Commercial Code have not been set forth in the Petition but are described in detail in the opinion of the Second Circuit Court of Appeals.[1]

Counterstatement of the Case

In December 1982, respondent Aircraft Trading and Services, Inc. ("ATASCO") sold a jet aircraft engine (the "Engine") to Northeastern Airlines ("Northeastern") a United States commercial airline carrier, subject to a chattel mortgage ("Chattel Mortgage") securing the payment in full by Northeastern of the purchase price. The Chattel Mortgage, which Northeastern was obligated to file with the Federal Aviation Agency ("F.A.A.") expressly prohibited Northeastern from transferring or assigning the engine without ATASCO's approval until full payment of the purchase price had been made. Neither Northeastern nor ATASCO filed the Chattel Mortgage at that time. ATASCO ultimately did file the Chattel Mortgage in March, 1985.

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[1]The provisions of the Uniform Commercial Code involve pure issues of State law that require no determination by this Court. The Brief submitted in support of the Petition by Braniff raises State law issues which need not be addressed by this Court.

On November 28, 1984 Northeastern, in financial difficulty and indebted to Braniff, Inc. ("Braniff"), agreed to sell an aircraft containing the Engine to Braniff, another commercial airline carrier. Braniff checked the F.A.A. records for prior claims or liens upon the aircraft and its parts and found no filed claims. After the sale to Braniff was consummated, Braniff filed its Bill of Sale with the F.A.A. on November 30, 1984, and on December 7, 1984 Braniff sold the aircraft to William Condren after Condren also checked the F.A.A. records for a prior claim. Thereafter, Condren filed his Bill of Sale.

In early February, 1985 Condren leased the aircraft, with the Engine, with an option to buy to International Air Leases ("I.A.L."). The lease was never filed with the F.A.A., as required by 49 U.S.C. §1403. ATASCO filed its Chattel Mortgage with the F.A.A. in March of 1985 and in April of 1985 I.A.L. learned of ATASCO's Chattel Mortgage when Condren notified I.A.L. of ATASCO's interest by letter.

In June, 1985, I.A.L. actually procured a copy of ATASCO's Chattel Mortgage from the F.A.A. and was fully aware of its terms and conditions. Nevertheless, in late or early August of 1985, with full knowledge of ATASCO's Chattel Mortgage, I.A.L. exercised its option to buy the aircraft, including the Engine. I.A.L.'s Bill of Sale from Condren was filed with the F.A.A. on August 5, 1985, some four months after ATASCO's Chattel Mortgage was filed.

On August 27, 1985, ATASCO sued Braniff, Condren and I.A.L. for conversion, replevin and foreclosure on its Chattel Mortgage. Following discovery, ATASCO moved for summary judgment against I.A.L. only. I.A.L., Braniff and Condren cross-moved for summary judgment against ATASCO.

The United States District Court for the Southern District of New York granted summary judgment in favor of I.A.L., Condren and Braniff and dismissed ATASCO's complaint. The

Court found that the intervening conveyances from Northeastern to Braniff and from Braniff to Condren, prior to the recordation of ATASCO's Chattel Mortgage, served to extinguish ATASCO's Chattel Mortgage.

The Second Circuit Court of Appeals affirmed the summary judgment granted in favor of Braniff and Condren but reversed the judgment in favor of I.A.L. and directed the District Court to enter summary judgment in favor of ATASCO as against I.A.L. The Second Circuit Court of Appeals properly read this Court's decision in *Philko Aviation, Inc.* v. *Shacket,* 462 U.S. 406 (1983) and 49 U.S.C. §§1403(c) and 1406 to require reference to applicable state law to determine priorities among conflicting security interests and title once filing with the F.A.A. has occurred. Under New York's version of the Uniform Commercial Code, the Court of Appeals properly found that I.A.L.'s title was subject to ATASCO's previously filed Chattel Mortgage.

ARGUMENT I

The decision of the Second Circuit Court of Appeals is consistent with this Court's decision in *Philko Aviation, Inc.* v. *Shacket,* 462 U.S. 406 (1983) and with 49 U.S.C. §§1403(c) and 1406.

The Petitioners contend that the decision of the Second Circuit Court of Appeals is in conflict with this Court's decision in *Philko Aviation, Inc.* v. *Shacket,* 462 U.S. 406 (1983). The predicate for such argument is this Court's statement in *Philko* that

> ". . . the primary congressional purpose for the enactment of §503(c) . . . was to create 'a central clearing house for recordation of titles so that a person. wherever he may be would know where he can find ready access to the claims against or liens or other legal interests in an aircraft.' "

The Petitioners' argument, however, ignores the distinction between this Court's decision in *Philko* and the facts of this case. Additionally, the Petitioners' argument ignores the plain statutory language of 49 U.S.C. §§1403(c) and 1406.

In *Philko,* this Court was presented with a factual situation in which no filing was ever made with the F.A.A. Illinois law allowed unrecorded transfers of interests in aircraft to take precedence over innocent purchasers. Consistent with 49 U.S.C. §1403(c), this Court held that state laws that allow unrecorded interests in aircraft to affect innocent third parties are preempted. In effect, the reference in 49 U.S.C. §1406 to State Law for determining priorities has no applicability until a security interest is properly filed in accordance with 49 U.S.C. §1403.

This Court's decision in *Philko* foreshadowed the factual situation presented by this case. Although this Court did not have to reach the question of what would occur if Shacket had filed his interest, it specifically noted that once an interest is filed, priority is determined under state law:

> In support of the judgment below, respondents rely on *In re Gary Aircraft Corp.,* 681 F.2d 365 (CA5 1983), which rejected the contention that § 503 preempted all state laws dealing with the priority of interests in aircraft. *The Court of Appeals held that the first person to record his interest with the F.A.A. is not assured of priority which is determined by reference to state law. We are inclined to agree with this rationale, but it does not help the Shackets. Although state law determines priority, all interests must be federally recorded before they can obtain whatever priority to which they are entitled under state law.* As one commentator has explained: 'the only situation which priority appears to be determined by operation of the [Federal] statute is where the security holder has failed to record his interest. Such failure invalidates

> the conveyance as to innocent third persons. But recordation merely validates it; it does not grant priority.' (citations omitted) 462 U.S. at 413. (Emphasis supplied.)

This case presents precisely the factual circumstances that this Court was addressing in the above-cited portion of *Philko*. Here, ATASCO did file its Chattel Mortgage and I.A.L. took title after such filing, with full knowledge of the filing and with full knowledge of the terms and conditions of ATASCO's Chattel Mortgage. Consistent with 49 U.S.C. §§1403(c) and 1406, upon ATASCO's filing its Chattel Mortgage, all questions of priority are determined under applicable state law. Under New York's version of the Uniform Commercial Code, ATASCO's Chattel Mortgage was subordinate to the titles of both Braniff and Condren, who took without knowledge of ATASCO's Chattel Mortgage. However, also under New York's version of the Uniform Commercial Code, ATASCO's Chattel Mortgage was superior to I.A.L.'s title.

Petitioners claim that the decision of the Second Circuit Court of Appeals conflicts with the policy underlying the creation of a central registry for the recordation of interests in aircraft. However, as the Court of Appeals noted, Petitioners ignore the specific use of the word "until" in §1403(c)—rather than the word "unless"—and also ignore the Congressional decision to refer all questions of priority to applicable state law under §1406 once recordation with the F.A.A. has occurred. If Congress had intended to have intervening conveyances extinguish unfiled security interests without reference to state law, it would have been a simple matter for Congress to have so provided in the Federal Aviation Act. It did not do so. Instead, it specifically provided that no conveyances would be valid against innocent purchasers *"until* such conveyance or other instrument is filed for recordation in the office of the Secretary of Transportation." (49 U.S.C. §1403(c)).

Moreover, §1403(c) does not absolutely invadidate an un-

filed security interest. Under §1403(c), even an unfiled security interest is valid against the maker thereof and against all persons with actual notice of the security interest. Thus, while it was clearly the Congressional intention to establish a central office for the recordation of interests in aircraft, it was just as clearly not the intention of Congress to make filing an absolute condition precedent to the validity of interests in aircraft or aircraft parts.

Equally important, §1403 contains no time limitations upon the recordation of interests or provide for the extinguishment of interests under Federal law by virtue of the creation of intervening interests. Although Petitioners shrink from a full articulation of this position, it is clear that their position requires reading into §1403 a provision that an intervening interest, created prior to filing, will extinguish the unfiled interest and preclude the filing from having any effect. Under this formulation, §1406 becomes superfluous and the word "until" in §1403(c) is read out of the statute.

While Petitioners contend that the result reached by the Second Circuit Court of Appeals is commercially unreasonable, in truth, it is the interpretation of §1403 argued for by Petitioners that is commercially unreasonable. A secured lender could never assure the validity of a security interest unless it actually retained possession of the collateral until its security interest was filed wtih the F.A.A. Without such possession, even a single day's delay in filing would enable an unscrupulous borrower to grant other security interests or even sell the aircraft in the interim. Under Petitioners' formulation, such a conveyance would extinguish the secured lender's security interest.[2] The Federal Aviation Act clearly did not contemplate

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[2]Significantly, this result would nullify all of the relation-back of perfection provisions of the Uniform Commercial Code, made applicable by §1406. These relation-back provisions were clearly intended to prevent the precise result sought by Petitioners.

such a result. Thus, the result reached by the Second Circuit Court of Appeals is both consistent with *Philko* and with the clear and unambiguous language and the purpose of 49 U.S.C. §§1403(c) and 1406.

Petitioners' reference to *South Shore Bank* v. *Tony Mat, Inc.*, 712 F.2d 896 (3d Cir. 1983) is misplaced. Contrary to Petitioners' contention, the *Tony Mat* case is consistent with the decision of the Second Circuit Court of Appeals. In *Tony Mat*, the Third Circuit specifically recognized that the case differed from *Philko* because Tony Mat did eventually file its interest with the F.A.A. As such, 49 U.S.C. §1406 required reference to state law (in that case, Massachusetts' version of the Uniform Commercial Code). While South Shore Bank prevailed under the Uniform Commercial Code, the result was not dictated by §1403. If Tony Mat's interest had been extinguished by the intervening security interest created in favor of South Shore Bank, there would have been no need for the Court to have addressed the Uniform Commercial Code in order to reach a decision.

Similarly, Petitioners' reference to *South Shore Bank* v. *Johnson Hydraulic Mfg. Co.*, 131 Ill. App. 3d 1024, 477 N.E. 2d 1 (1985) and *Bank of Honolulu* v. *Davis*, 709 P.2d 613 (Intermed Ct. App. 1985) are also misplaced. In *South Shore Bank*, the unrecorded interest was held to prevail under Illinois law prior to this Court's decision in *Philko*. Upon reconsideration after *Philko*, the Court merely held that as to South Shore Bank, Johnson's interest was unrecorded and hence the Bank's rights are "superior" to Johnson's. In effect, the Bank stood in a similar position to that of Braniff and Condren with Johnson standing in a position similar to that of ATASCO. No one in the South Shore Bank case, however, occupied a position similar to that of I.A.L. Thus, the precise issue involved in this case was not involved in *South Shore Bank*.

In the *Bank of Honolulu* case, as in *Philko,* the putative buyer of the aircraft neglected to file its interest with the F.A.A. Thus, as to the judgment creditor, the buyer's title was inferior. The case did not, however, address what would have happened if the buyer had filed its interest and also did not address what would happen if, after the buyer had filed, the judgment creditor had attempted to convey her interest. In short, none of the cases cited by petitioners support their position.

The arguments raised by Braniff are largely founded on its view of what the result should be under the Uniform Commercial Code. Indeed, Braniff conceded, in its argument to the Second Circuit Court of Appeals, that §1403(c) and *Philko* are not controlling because ATASCO did file its Chattel Mortgage. Braniff argued, and continues to argue, that I.A.L. should prevail under the Uniform Commercial Code. ATASCO disputes this contention but shall refrain from addressing it here as it presents no issue for this Court to resolve. The Second Circuit Court of Appeals properly resolved the State Law issues in its decision.

CONCLUSION

For all of the foregoing reasons, it is respectfully submitted that the Petition for a Writ of Certiorari should be denied as it raises no issue of Federal Law and the decision of the Second Circuit Court of Appeals is consistent with this Court's decision in *Philko Aviation, Inc.* v. *Shacket,* 462 U.S. 406 (1983).

Respectfully submitted

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